REPORT OF EXAMINATION
OF THE

CITATION INSURANCE COMPANY

AS OF
DECEMBER 31, 2006

Participating State
and Zone:

California

Filed June 20, 2008

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San Francisco, California
May 2, 2008

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Morris Chavez
Secretary, Zone IV-Western
Superintendent of Insurance
New Mexico Insurance Division
Santa Fe, New Mexico

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary and Commissioner:

Pursuant to your instructions, an examination was made of the

CITATION INSURANCE COMPANY

(hereinafter referred to as the Company) at the primary location of its books and records, One Easton Oval, Suite 530, Columbus, Ohio 43219. The Company's statutory home office and main administrative office is located at 875 Prospect Street, Suite 301, La Jolla, California 92037.

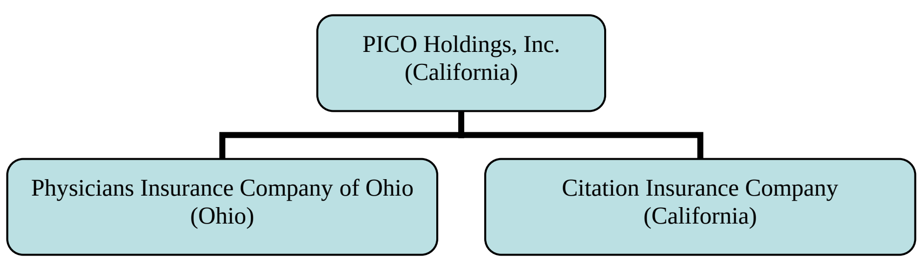
SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2002. This examination covers the period from January 1, 2003 through December 31, 2006. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. This examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions, an evaluation of assets, and a determination of liabilities as of December 31, 2006, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: company history; corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; loss experience; business in force by states; and sales and advertising.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system in which PICO Holdings, Inc. (PICO), a California corporation, is the ultimate controlling entity. The Company is a wholly-owned subsidiary of PICO. The following chart depicts the interrelationship of the companies within the holding company system as of December 31, 2006 (all ownership is 100%):



Management of the Company is vested in a three-member board of directors elected annually. As of December 31, 2006, the directors and principal officers were as follows:

Directors

Name and Residence	Principal Business Affiliation
John R. Hart La Jolla, California	President PICO Holdings, Inc.
Ronald Langley La Jolla, California	Chairman PICO Holdings, Inc.
Richard H. Sharpe La Jolla, California	Chief Operating Officer PICO Holdings, Inc.

Principal Officers

Name	Title
John R. Hart	President
James F. Mosier	Secretary
Maxim C.W. Webb	Treasurer
Richard H. Sharpe	Chief Operating Officer
John S. Bricker	Controller

Intercompany Agreements

The Company and its parent, PICO Holdings, Inc. (PICO), entered into an Investment Management Agreement effective July 1, 2000. PICO provides investment services to the Company. The Company pays PICO based on actual time spent by PICO employees on the investment functions for the Company. This agreement was approved by the California Department of Insurance (CDI) on December 20, 2000.

In addition to investment management, PICO performs certain management functions for the Company and allocates operating expenses for its services. This agreement was approved by the CDI on December 20, 2000.

The Company, its parent and affiliates file a consolidated federal income tax return under the provisions of a tax allocation agreement, which was executed on October 5, 1999. Each subsidiary is required to compute its tax liability as if it filed a separate federal tax return. Payment of the consolidated tax liability is the responsibility of the parent. This agreement was approved by the CDI in August 2000.

Conflict of Interest

The Company has a "Code of Business Conduct and Ethics" policy. This policy was enacted in 2004 at the parent company level in compliance with NASDAQ Listing Rules, at which time, the board, management and key employees signed the policy. No change was made in 2005 and no new forms were signed. Due to change in the policy statement in 2006, the board, management and key employees signed the policy in 2006. The Company does not require signing of this document every year. It is recommended that the Company establish written procedures to require annual conflict of interest reporting for its directors, officers and key employees.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2006, the Company is licensed to write in Arizona, California, Colorado, Hawaii, Nevada, New Mexico, and Utah.

Effective June 30, 1996, the Company ceased writing workers' compensation business. On June 30, 1997, the Company ceded all workers' compensation loss reserves to its then subsidiary, Citation National Insurance Company, which was simultaneously sold to Fremont Indemnity Company as of the same date. In June of 2003 Fremont Indemnity Company was conserved by the California Department of Insurance and the remaining workers' compensation loss reserves were returned to the Company resulting in an increase to the Company's loss and loss adjustment expenses in the amount of $7,697,571.

In 1997, the Company ceased writing commercial business in California. In 1998, the only business remaining was in Arizona, which consisted mainly of property coverage on apartments and merchants buildings and liability coverage on restaurant businesses.

As of December 31, 2000, the Company ceased writing new business and its last policy expired on December 31, 2001. Although the Company was in runoff status, it continued to assume a small portion of commercial auto liability business from the California Commercial Auto Insurance Procedure (CAIP) pool through 2003. From 2004 to 2006, the Company did not assume any business from the CAIP pool.

REINSURANCE

Assumed

Except for some commercial automobile property and liability risks from the California Commercial Auto Insurance Procedure referenced above, the Company does not assume any reinsurance.

Ceded

The Company has been in runoff since January 1, 2001. The following is a summary of principal reinsurance agreements in effect.

Type of Contract	Reinsurer	Company's Retention	Reinsurer's Maximum Limit
Workers' Compensation			
First Excess Liability (1986-1987)	General Reinsurance Corporation	$150,000	$5,000,000 per occurrence
First Excess Liability (1988-1989)	General Reinsurance Corporation	$200,000	$5 million per occurrence
First Excess Liability (1990-1998)	General Reinsurance Corporation	$250,000	$5 million per occurrence
Artisan and Contractors			
First Excess Liability	General Reinsurance Corporation	$125,000	$125,000 per occurrence
Second Excess Liability	General Reinsurance Corporation	$250,000	$2.75 million per occurrence

Type of Contract	Reinsurer	Company's Retention	Reinsurer's Maximum Limit
First Excess Liability	General Reinsurance Corporation	$75,000	$175,000 subject to a maximum of $525,000 on all risks involved in one occurrence
Second Excess Property	General Reinsurance Corporation	$250,000	$2.75 million subject to a maximum of $4.125 million on all risks involved in one occurrence

ACCOUNTS AND RECORDS

During the course of the examination, a review was made of the Company's general controls over its information systems. Some weaknesses were noted in areas such as an enterprise-wide business continuity/disaster recovery plan policies; and procedures to address the adding, changing and deleting of individual's access rights to the Company's computer resources, applications and program files. The weaknesses noted were presented to the Company along with recommendations to strengthen its controls. The Company is in the process of evaluating the recommendations and making appropriate changes to strengthen its information systems controls.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2006

Underwriting and Investment Exhibit for the Year Ended December 31, 2006

Reconciliation of Surplus as Regards Policyholders from December 31, 2002 through December 31, 2006

Reconciliation of Examination Changes as of December 31, 2006

Statement of Financial Condition
as of December 31, 2006

Assets	Ledger and Nonledger Assests	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$12,047,161	$	$12,047,161	(1)
Common stocks	36,509,181	8,174,982	28,334,199	(1)
Cash and short-term investments	1,553,240		1,553,240	(2)
Investment income due and accrued	160,056		160,056	
Amounts recoverable from reinsurers	317,759		317,759	
Funds held by or deposited with reinsured companies	152,345		152,345	
Federal income tax recoverable	690,346	690,346		
Electronic data processing equipment and software	432		432	
Furniture and equipment	2,054	2,054		
Receivables from parent, subsidiaries, and affiliates	983,681	951,042	32,639	
Aggregate write-ins for other than invested assets	28,122	28,122		
Total assets	$52,444,377	$ 9,846,546	$42,597,831	

Liabilities, Surplus and Other Funds			
Losses		$ 9,911,267	(3)
Loss adjustment expenses		5,252,577	(3)
Other expenses		403,310	
Net deferred tax liability		474,519	(4)
Ceded reinsurance premiums payable		317,431	
Amounts withheld or retained by the company for account of others		193,575	
Provision for reinsurance		12,183	
Payable to parent, subsidiaries and affiliates		88,029	
Aggregate write-ins for liabilities		2,038,905	
Total liabilities		18,691,796	
Common capital stock	$ 5,000,000		
Gross paid-in and contributed surplus	26,553,731		
Unassigned funds (surplus)	(7,647,696)		
Surplus as regards policyholders		23,906,035	
Total liabilities, surplus and other funds		$42,597,831	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2006

Statement of Income

Underwriting Income		
Premiums earned		$ 0
Deductions:		
Losses incurred	$ 511,951	
Loss expenses incurred	(446,792)	
Other underwriting expenses incurred	640,598	
Total underwriting deductions		705,757
Net underwriting loss		(705,757)
Investment Income		
Net investment income earned	$ 934,079	
Net realized capital gains	2,372,034	
Net investment gain		3,306,113
Other Income		
Aggregate write-ins for miscellaneous income	$ 8,920	
Total other income		8,920
Net income before federal and foreign income taxes		2,609,276
Federal and foreign income taxes incurred		1,583,438
Net income		$ 1,025,838

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2005		$ 25,401,061
Net gain	$ 1,025,838	
Net unrealized capital losses	(2,551,231)	
Change in unrealized foreign exchange capital gain	180,312	
Change in net deferred income tax	3,530,164	
Change in nonadmitted assets	(3,859,372)	
Change in provision for reinsurance	179,263	
Change in surplus as regards policyholders for the year		(1,495,026)
Surplus as regards policyholders, December 31, 2006		$ 23,906,035

Reconciliation of Surplus as Regards Policyholders
from December 31, 2002 through December 31, 2006

Surplus as regards policyholders, December 31, 2002, per Examination			$ 9,968,035
	Gain in Surplus	Loss in Surplus	
Net loss	$ 3,551,377	$	
Net unrealized capital gains	9,562,530		
Change in unrealized foreign exchange capital gains	425,077		
Change in net deferred tax	6,330,745		
Change in nonadmitted assets		5,919,547	
Change in provision for reinsurance		12,182	
Total gains and losses	$19,869,729	$ 5,931,729	
Increase in surplus as regards policyholders			13,938,000
Surplus as regards policyholders, December 31, 2006, per Examination			$ 23,906,035

Reconciliation of Examination Changes
as of December 31, 2006

Liabilities	Per Company	Per Examination	Increase (Decrease) in Surplus	Note
Losses and loss adjustment expenses	$12,686,684	$15,163,844	$(2,477,160)	(2)
Net decrease to unassigned funds			$(2,477,160)	
Surplus as regards policyholders, December 31, 2006, per Company			26,383,195	
Surplus as regards policyholders, December 31, 2006, per Examination			$23,906,035	

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds and Common Stocks

The Company has not filed its custodial agreement with Bank of New York Trust Company, dated December 17, 2003. It is recommended that the Company file its custodial agreement with California Department of Insurance (CDI) as required by California Insurance Code (CIC), Section 1104.9(c).

(2) Cash and Short-term Investments

The Company does not have a formal written policy regarding escheat procedures. Additionally, the Company has not filed reports during the examination period with the California State Controller under the California Unclaimed Property Act. It is recommended that Company develop a formal policy in regards to escheat procedures. It is recommended that the Company file reports with the California State Controller in accordance with the California Unclaimed Property Act.

(3) Losses and Loss Adjustment Expenses

A Casualty Actuary from the California Department of Insurance (CDI) reviewed the loss and loss adjustment expense reserves and based on subsequent development and other factors concluded that the reserves were deficient by $2,477,160. An examination adjustment was made.

(4) Net Deferred Tax Liability

There was an adjustment made by the Deloitte & Touche, LLP (Deloitte), resulting in an increase in deferred tax liability by $897,148. The Company agreed with the finding and made proper adjustment in 2007. No adjustment was made as the amount is immaterial.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control (Page 2): It is recommended that the Company establish written procedures to require annual conflict of interest reporting for its directors, officers and key employees.

Accounts and Records (Page 6): The Company should evaluate the recommendations from the information systems control review and make appropriate changes to strengthen its information systems controls.

Comments on Financial Statement Items – Bonds and Common Stocks (Page 12): It is recommended that the Company file its custodial agreement with California Department of Insurance as required by California Insurance Code, Section 1104.9(c).

Comments on Financial Statement Items - Cash and Short-term Investments (Page 12): It is recommended that Company develop a formal policy in regards to escheat procedures. It is recommended that the Company file reports with the California State Controller in accordance with the California Unclaimed Property Act.

Previous Report of Examination

Accounts and Records (Page 7): The Company should evaluate the recommendations from the information systems control review and make appropriate changes to strengthen its information systems controls. No follow-up was performed with respect to these finding and recommendation as they were applicable to the Sequoia Insurance's (an affiliate during the last exam) IS operations that provided the Company with IT support. Sequoia was sold to a third-party in 2003 and the IT services and support were moved to third-party vendors.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

/S/

Kyo Chu, CFE
Senior Insurance Examiner
Department of Insurance
State of California